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STUDENT NOTES

STATUTES OF LIMITATION AS APPLIED TO NEGOTIABLE INSTRUMENTS IN KENTUCKY

A frequent and perplexing problem in Kentucky practice is the application of the statutes of limitation to promissory notes. This is due to the fact that we have two statutes of limitation which are applicable to these instruments.

KRS 413.090 provides:

The following actions shall be commenced within fifteen years after the cause of action first accrued. . . (2) an action upon a recognizance, bond or written contract.

KRS 413.120 provides:

The following actions shall be commenced within five years after the cause of action accrued: . . . (8) an action upon a bill of exchange, check, draft or order, or any endorsement thereof, or upon a promissory note placed upon the footing of a bill of exchange.

The court has held that a promissory note, although having all the requisites for negotiability, is merely a written contract and within the fifteen year statute unless it has been negotiated by the payee to a holder in due course.¹ However, if there has been such a negotiation, a note is placed upon the footing of a bill of exchange and comes within the five-year statute. This requires that the note be negotiated in good faith and for value before maturity.²

The problem, then, is to determine what constitutes negotiation so as to place a note on the footing of a bill of exchange. A survey of a number of cases illustrates the situations which have been held to negotiate or not to negotiate a note.

The transfer of a note made payable to the cashier of a bank, endorsed by him and placed upon the books of the bank as an asset, when in fact it was a transaction between the maker and the bank, is not sufficient negotiation to prevent the application of the fifteen year statute.³ However, a corporation's endorsement of a note for value to one of its officers does negotiate it and place it upon the footing of a bill of exchange.⁴

¹ Alexander v. West, 241 Ky. 541, 44 S.W. (2d) 518 (1931); Richardson's Adm. v. Morgan, 233 Ky. 540, 26 S.W. (2d) 32 (1930); Southern National Bank v. Schimpler, 160 Ky. 813, 170 S.W. 178 (1914).

² First State Bank v. Parratt, 255 Ky. 615, 75 S.W. (2d) 46 (1934); Hazel v. McCullough, 188 Ky. 419, 222 S.W. 100 (1920).

³ Farmers National Bank of Glasgow v. Guthrie, 284 Ky. 583, 145 S.W. (2d) 518 (1940).

⁴ Holt Bros. Mining Co. v. Stewart, 250 Ky. 199, 61 S.W. (2d) 1073 (1933).

The transfer of a note from one bank to another in the process of consolidation and merger will not affect the application of the fifteen year statute.⁵ Likewise, if a surety pay a note for the principal and receive the note, it is said to be a "transferred" and not a negotiated note and still within the fifteen year statute.⁶

A note is not negotiated so as to bring it within the five year statute when it is placed as collateral for another note and is returned when the indebtedness is paid.⁷ However, when the note pledged as collateral is for a greater amount than the obligation it secures, and the obligation is not paid at maturity, the amount of the note sufficient to pay the defaulted obligation is held to be negotiated and within the five year statute, while the remainder of the note is not negotiated and within the fifteen year statute.⁸

Reacquisition by the payee presents an interesting problem. In *Sweeny et al. v. Taylor's Executor*,⁹ a note had been negotiated by the payee and thus subjected to the five year statute. It was later reacquired by the payee and the court held that this was sufficient to again subject it to the fifteen year statute. This is true although the note was retransferred to the payee after maturity. This result is explained under the "Old Shoes" theory that one who reacquires a negotiable instrument holds it with the same rights and subject to the same defenses as when he originally held it. The application of this theory provides a simple means of avoiding the five year statute by a retransfer to the payee. Apparently, in such a case involving a matured note the payee could again transfer the note to any person, including the person from whom he reacquired it, and the fifteen year statute would be applicable. However, this transfer must be made to the original payee by the holder in due course before the five year statute has run.¹⁰

Another interesting question which may arise is the effect of a transfer by the payee through a restrictive endorsement. Since a restrictive endorsement prohibits further negotiation of the note and constitutes the endorsee the agent or trustee of the endorser,¹¹ it can be reasoned that the transferee of a note bearing a restricted endorsement would be considered the agent of the payee and the note would remain within the fifteen year statute. The court reached this result in holding that a note endorsed by the payee to a third party for the purpose of collection only remains within the fifteen year statute.¹²

⁵ *National Bank of Lima v. Deaton*, 279 Ky. 606, 131 S.W. (2d) 495 (1939).

⁶ *Redford v. Crowe's Adm'x*, 225 Ky. 142, 7 S.W. (2d) 842 (1928).

⁷ *Combs v. Salyer*, 291 Ky. 592, 165 S.W. (2d) 40 (1942).

⁸ *Thomas v. Siddens*, 261 Ky. 613, 88 S.W. (2d) 277 (1935).

⁹ 205 Ky. 390, 266 S.W. 665 (1924).

¹⁰ See *Sweeny et al v. Taylor's Exec.*, 205 Ky. 390 at 394, 266 S.W. 665 at 667 (1924).

¹¹ KRS 356.036.

¹² *Coleman v. Coleman's Executor*, 189 Ky. 96, 224 S.W. 668 (1920).

Attention is called to the fact that the rules stated above do not apply to sureties on a negotiable instrument. A special statute in Kentucky bars suits against sureties seven years after the cause of action first accrued.¹³ This statute, however, does not apply to endorers.¹⁴ Since it is apparently immaterial whether the obligation is negotiable or non-negotiable, a transfer of the instrument would probably not affect the period of limitation as applied to a surety. Several interesting problems could arise in the application of this statute on which the writer is unable to find any authority, as, for example, where a suit is brought against one who is a principal in form but a surety in fact.

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¹³ KRS 413.220.

¹⁴ *Stokes et al. v. Farmers and Merchants Bank of Elkton*, 241 Ky. 699, 44 S.W. (2d) 837 (1931).